UCRS Advisory Board

MINUTES
UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM (UCRS)
ADVISORY BOARD MEETING
FRIDAY, FEBRUARY 25, 2011
10:00 AM

BOARD MEMBERS PRESENT: Chair Oakley, Vice Chair Sandbrook, Vice President Duckett, Chief Investment Officer Berggren, Vice Chancellor Michaels, Professor Starr (via telephone), Maintenance Worker Piper, CUCRA Chair Gade and CUCEA Chair Newbrun.

BOARD MEMBERS ABSENT: Executive Vice President Brostrom, Interim Human Resources Director Hiemstra.

STAFF PRESENT: Chief Financial Officer Taylor, Executive Director Baptista, Principal Counsel Clark, Director Lange, Director Lewis, Director Lorenz, Director Olson, Director Schlimgen, Associate Director Anguiano, Associate Director Ashcraft, Manager Dibrell, Manager Chen-Ok, Manager Ryan, Specialist Reicher, Principal Analyst Semple, Principal Analyst West, Principal Analyst Whalen.

OTHERS PRESENT: Associate Vice President Obley (via telephone), CUCEA Chair Elect Duffus (via telephone), CUCEA/CUCRA Benefits Committee Chair Harris (via telephone), UCB Retiree Association Representative Sweet, CUCFA Representative Hays, CUCFA Representative Kiskis, UCRS Actuary Monroe (The Segal Company).

The meeting officially opened at 10:07 a.m.

COMMENTS FROM THE CHAIR: Chair Oakley called the meeting to order and immediately commenced the public-comment period.

PUBLIC-COMMENT PERIOD: CUCFA Representative Kiskis made the following comments: post-employment benefits (PEB) are a type of deferred compensation that members earn while actively working; The Regents have a fiduciary duty to protect such benefits; he agreed generally with the letter sent to the Board Chair by AFSCME Local 3299 Representative Raider; he hoped that the Board Chair will afford guests/observers the ability to comment throughout Board meetings and not just during public-comment periods; he questioned the necessity for closed/executive sessions and believes that guests/observers should at a minimum be advised of the topics being discussed; and he hoped that memoranda from the Board Chair to the President will be posted on the Board's website and be available to the public. With respect to agenda item C on pension reform, Professor Kiskis hoped that UC speaks out against proposed Congressional legislation that could allow states to declare bankruptcy and possibly default on pension obligations. (In response to this comment, Chair Oakley indicated that it was unlikely that states would declare bankruptcy, even if allowed, as it would hamper their ability to borrow and dramatically increase their interest rates.) Finally, with respect to agenda item M on the preview of the UCRP experience study, Professor Kiskis noted that the 10-year return for UCRP was only 3.8% and indicated that the UCRP assumed rate of return should be reviewed.

CUCEA/CUCRA Benefits Committee Chair Harris stated that, for cost-saving purposes, guest/observers should be allowed to participate in meetings via teleconference and that Board Handbook changes should allow guests/observers participating via the telephone to comment and/or ask questions.

APPROVAL OF THE MINUTES: Chair Oakley called for approval of the minutes from the Board meeting of November 19, 2010. The minutes of the meeting were approved by acclamation.

COMMENTS FROM THE CHAIR: Chair Oakley noted his agreement with CUCFA Representative Kiskis that post-employment benefits are "earned" and he cautioned against characterizing such benefits as "give-a-ways." He deferred discussion of changes to the Handbook to discussion of today's Item D.

CHIEF INVESTMENT OFFICER - REPORT: Chief Investment Officer (CIO) and Board Member Berggren stated that the last quarter of 2010 had been very strong. UCRP had a return of over 6% and outperformed its benchmark by 36 basis points. She credited both asset allocation and fund selection with contributing to UCRP's positive return for the quarter. UCRP was slightly overweight in equities, which performed well; high yield bonds had another strong quarter, which was unusual during a period in which equities also did well; absolute returns had better than expected returns, outperforming its benchmark by 438 basis points; and private equity and real estate showed signs of improvement.

Based on a Member's request from the November meeting, CIO Berggren provided a chart of UCRP returns over a 20-year period. She noted that UCRP had outperformed its policy benchmark in 15 out of the last 20 years (i.e., 75% of the time over a two-decade period), which she attributed to diversification within UCRP. She stressed that UCRP returns must be viewed from a long-term perspective, noting that the current 3-year return for UCRP was negative and had not been so low since the 2001 recession. She summarized the process for selecting outside managers; she also observed that a healthy stock market would benefit the state in terms of tax revenues, but could not erase the state's debt.

EXECUTIVE VICE PRESIDENT, BUSINESS OPERATIONS - UPDATE: As Executive Vice President Brostrom was unable to attend, the budget update was given by Associate Vice President Obley, who called from Sacramento. She said the state Senate and Assembly had adopted different versions of a budget but that there was a desire to put a unified budget together by March 10, 2011. She noted that the $500 million cut slated for UC appears to be unavoidable and that UC could face additional cuts of $250 to $500 million if the Governor's proposed tax extensions are not placed on the June ballot and approved. She described the significant UC advocacy effort to inform the state that UC cannot absorb further budget cuts. For the first time, UC will receive more of its funding from student tuition than from the state. She stated that the Assembly Speaker's Office may introduce budget language that could restrict UC's ability to administer/allocate spending cuts. In response to a member's question, she confirmed that language in the budget indicating that the state would not provide any future funding for UCRP had been omitted.

ITEM A. UC POST-EMPLOYMENT BENEFITS - UPDATE: Director Schlimgen said that The Regents had approved the President's post-employment benefits (PEB) recommendations at its special meeting of December 13, 2010. He confirmed that the Regents had also approved ad hoc and annual cost of living allowances (COLAs) for UC PERS Plus 5 members, which the Board members discussed favorably at several prior meetings, and granted the President authority to fund the UCRP annual required contribution (ARC) as quickly as practical using two options to supplement required employer/employee contributions (transfers from the Short Term Investment Pool [STIP] and restructuring existing debt) starting in FY 2011. (Both issues were discussed in more detail as separate agenda items.) Director Schlimgen reported that his staff is beginning to evaluate the option of a defined contribution plan (DC plan) for Clinical Enterprises employees, as recommended by President's PEB Task Force, but clarified that medical centers would remain responsible for their share of UCRP's unfunded (legacy) liability even if a DC plan were implemented. He said his staff is also beginning to evaluate UCRP's new-tier implementation issues, such as whether former members rehired on/after July 1, 2013 would earn benefits under the old or new UCRP formula and asked for opinions from Board members. A discussion ensued and the Chair, along with several other members, opined that former UCRP members rehired after a break in service should fall under the new UCRP formula. The Chair asked if any member disagreed and received no response. The Chair requested ongoing updates on implementation issues.

ITEM B. UCRP - MARCH 2011 REGENTS ITEM - ADDITIONAL CONTRIBUTIONS TOWARDS THE ANNUAL REQUIRED CONTRIBUTION: Chief Financial Officer and Vice President Taylor indicated his goal is to get money into UCRP to meet the plan's ARC as quickly as possible. At its December 13, 2010 meeting, The Regents gave the President authority to transfer assets to UCRP under two different options (described above in Item A) to satisfy the plan's ARC as quickly as possible, starting in FY 2011.[1] CFO Taylor will present a Regents' item in March that provides another potential UCRP funding option that the President may use, bringing the total to three, and moves up the start date for transferring assets to FY 2010. The additional contributions over the next two fiscal years would provide $2.1 billion dollars to UCRP that is in addition to the previously approved employer and employee contributions. That amount would cover UCRP's "modified ARC," that is, UCRP's normal cost plus the interest on its unfunded liability. Under the new funding option, The Regents could issue variable corporate bonds in lieu of transferring funds from STIP. CFO Taylor noted that such a bond issuance could be more expensive on a fixed-rate basis, but could be a good option on a short-term, variable basis. In response to a member's question, he clarified that none of the options would be considered a loan that would need to be repaid by UCRP. Campus and medical-center payroll funds would be assessed a fee to pay both the principal and interest on either a STIP Note or bond issuance. At the Chair's urging, he explained that the three proposed options were alternatives to raising UCRP employer contribution rates to extremely high levels that locations could not sustain. He noted that location funding sources, such as federal contracts and grants, could be charged their share of the additional UCRP contributions

[1] Normal cost represents the cost allocated to an additional year of service credit for all active UCRP members. The plan's ARC for a fiscal year includes the normal cost plus the amount required to amortize the plan's unfunded liability determined over 30 years.

and that any of the options, if implemented, would improve UCRP's funded status, lower unfunded liabilities that must be reported on UC's balance sheets, and reduce the amount of employer contributions to UCRP in the future.

ITEM C. DISCUSSION OF PENSION REFORM DEVELOPMENTS IN CALIFORNIA: Vice President and Actuary John Monroe of the Segal Company described the California Actuarial Advisory Panel (CAAP), which was created by the Governor's Public Employee Post-Employment Benefits Commission to develop standards and best practices for public retirement plans and their actuaries. He noted that Actuary Angelo was absent due to a meeting of CAAP, which he had been asked to join by UC. Following a brief comparison of selected California public retirement systems, Actuary Monroe reported that CalPERS had a lower normal cost than UCRP because its assumed rate of return was higher than UCRP's. Also, CalPERS uses a 15-year smoothing method to recognize investment gains and losses whereas UCRP, and roughly 80% of other public retirement systems, use a 5-year smoothing method. When asked why the Orange County Employees' Retirement System (OCERS) had such a high normal cost, he replied that it was attributable to OCERS's large number of safety personnel. Safety members generally have a more generous benefit formula than non-safety members. Actuary Monroe noted that Moody's credit-rating service has taken the position that unfunded public pension liability may be understated and has begun to treat it like bond debt. He briefly summarized some reforms enacted or being considered by public retirement plans within the state: OCERS has adopted an optional DB/DC plan combination and initiated a "self-borrowing" financing plan similar to the STIP borrowing being considered for UCRP; CalPERS and many of its bargaining units have agreed to roll back benefits to the "2% at 60" level and increase member contribution rates from 8% to 10% of pay; and the California Foundation for Fiscal Responsibility (CFFR) has drafted two alternative pension-reform proposals (which they hoped to get on the June 2012 ballot) that would require existing members to pay half the cost of their retirement and retiree health benefits and include a DC plan for new hires, a cap on benefit payments, and limit retiree health benefits prior to age 65. Actuary Monroe said a constitutional amendment would be necessary to enact the CFFR reforms, which would apply to all public pension systems in the state. In closing, he noted that the Legislative Analyst's Office recently recommended a series of pension reforms, including more cost sharing by employees and more DB/DC plan combinations.

ITEM D. UCRS ADVISORY BOARD - SUGGESTED HANDBOOK AMENDMENTS RELATED TO BOARD PARTICIPATION AND PROCEDURES - UPDATE: Chair Oakley stated that he believes the proposed current draft of Handbook amendments, which have undergone revision since first presented to the Board in a November 2010 draft, make the Board meetings more open and accessible to guests/observers. In response to concerns about guest/observer comments being limited to the public-comment period, he indicated that the latest version of the Handbook amendments gives the Board's Chair the discretion to allow comments from guests/observers at any time. To prevent guests/observers on the telephone form interrupting a meeting, he clarified that the Chair should periodically inquire if such participants wish to comment. One member stressed the importance of allowing guests/observers to comment at any time during the meeting and stated that closed/executive sessions foster a sense of exclusivity and cautioned that not everyone reading the Handbook would interpret the language as promoting public accessibility to Board meetings. Chair Oakley responded that closed/executive sessions are infrequent but sometimes necessary. Additionally, he noted that while the Chair has the ability to request closed/executive sessions, Board members could overrule the Chair, in accordance with Robert's Rules of Order which govern the Board proceedings. He also indicated that future Board members would have the ability to change Board procedures. He thanked the subcommittee for its hard work on the Handbook and called for a motion to adopt the amendments. Hearing no objections, he announced that the revised draft of Handbook amendments was adopted.

ITEM E. UCRS ADVISORY BOARD - ELECTION OF STAFF MEMBERS: Principal Analyst Whalen reported that the election was for the two staff positions on the Board currently held by Members Hiemstra and Sandbrook whose terms end on June 30, 2011. The candidate nomination period will run from March 25th to May 6th and voting will occur between May 23rd and June 17th. The election will primarily be conducted via online voting, but UC employees without a work e-mail address will be mailed a physical ballot. The election process is being administered by a third-party administrator, VR Election Services, which has over 25 years of experience in conducting elections for large public retirement systems and a reputation for providing excellent security tools. Candidate statements will be posted on UC's At Your Service website in both English and Spanish. The winning candidates, who must be from different locations, will serve four- year terms beginning July 1, 2011, provided they remain active members of UCRP.

ITEM F. UCRS ADVISORY BOARD - SHAREPOINT - WEB BASED REPOSITORY FOR UCRS ADVISORY BOARD MATERIALS - UPDATE: Principal Analyst Semple reminded the Board that the SharePoint site proposed for the Board was intended to replace the former UCOP intranet site where Board agenda and items used to be posted. He explained that SharePoint was a secure site that required a password. Chair Oakley said he did not feel that the proposed SharePoint sites met the Board's needs and that he would prefer that Board materials be posted on a web page that is open to the public without the need for a password. He asked that staff continue to send agenda items directly to members via email and look at developing a public webpage.

ITEM G. RETIREMENT SAVINGS PROGRAM - VENDOR RELATIONS MANAGEMENT REPORT: Due to time constraints, Director Lange touched on the highlights of her report. She noted the following: Fidelity met all of its performance standards and financial education guarantees for the last quarter; the Retirement Saving Program ("RSP") net cash flow for the last quarter was negative due to a decrease in contributions and an increase in withdrawals, particularly minimum required distributions (MRDs) and distributions of small student-employee accounts. (MRDs had been suspended in 2009 as permitted under the Worker, Retiree and Employer Recovery Act of 2008.) Participation rates for the RSP continue to decline, although loan activity appears to be decreasing from its high point in the second quarter of 2010.

In response to the Vice Chair's concern that RSP participation dropped by 20% during the furlough period, Director Lange said that participants who stopped contributing have been contacted via mail. Executive Director Baptista indicated concern over low RSP balances and noted that Vendor Relations Management will be reaching out to younger workers to convey the importance of compounding over time.

Manager Chen-Ok presented a brief overview of MRDs, advising that over 11,000 were issued in 2010. Fidelity has implemented an automated MRD process for 2010 designed to facilitate compliance with requirements imposed by the Internal Revenue Code on tax-qualified plans such as the RSP plans. As part of the new process, in the first quarter of each year, Fidelity mails a standard communication to participants required to take an MRD for the first time. The automated MRD process will be described in the New Dimensions newsletter and on a UC/Fidelity micro-site. Vendor Relations Management will work with retiree associations to provide timely MRD articles for their newsletters. Several Board members reported that some participants have encountered problems with the automatic MRD process. Manager Chen-Ok told the Board he will continue to work with participants and Fidelity to refine the MRD process. Chair Oakley asked for an update at a future meeting.

ITEM H. DEPARTMENT OF LABOR FEE DISCLOSURE REQUIREMENTS - UPDATE: Manager Ryan reminded the Board that the Department of Labor's (DOL) new fee disclosure requirements do not apply to the RSP plans, as they are not subject to the Employee Retirement Income Security Act ("ERISA"), which is enforced by the DOL. Further, he indicated that Fidelity was not ready to provide an update on its compliance efforts because the DOL is still reviewing feedback received from service providers on the fee-disclosure requirements and has extended the effective date of the requirements to January 1, 2012.

NOTE: As the meeting was running behind schedule, Chair Oakley asked that the Plan Administrator's Annual Report (Item I), the Lump Sum Annual Cashout Report (Item J) and the item on the methodology for COLAs (Item K) be deferred until the June 2011 meeting.

ITEM L. UC PERS PLUS 5 PLAN - ANNUAL AND AD HOC COLAS - UPDATE: Specialist Reicher reiterated that The Regents had approved a 15.19% ad hoc COLA for UC PERS Plus 5 Plan members, which will bring their purchasing power up to the level of their UCRP counterparts who retired at the same time in 1991. The ad hoc COLA will be included with the April 2011 benefit and members will receive notification via their benefit-payment stub and by an article in the May 2011 New Dimensions newsletter. He also advised that members will begin receiving the same annual COLAs as their UCRP counterparts beginning fiscal year 2011.

ITEM M. UCRP - PREVIEW OF UPCOMING EXPERIENCE STUDY: Specialist Reicher noted that the Segal Company will be reviewing the appropriateness of UCRP's various actuarial assumptions, including its assumed rate of return, and hope to present an item to the Regents in May or July 2011. Any changes adopted will also apply to the UC PERS Plus 5 Plan and the 415(m) Restoration Plan. The Board will be advised in advance of the experience study being presented to The Regents.

<u>The open/regular session ended at 1:45</u>